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# How to enter grantor letter on 1040

Grantor Trusts: Tax Returns, Reporting Requirements and Options," that is the subject of today's ACTEC Trust & Estate Talk. Transcript/Show Notes This is Stacy Singer, ACTEC Fellow from Chicago. There are several different methods of reporting income tax from grantor trusts. To give us more information on this topic, you will be hearing today from ACTEC Fellow Greg Gadian from Tucson, Arizona. Welcome Greg! Thank you, Stacy. All of us in our practices have created grantor trusts for our clients. Typically, these trusts are irrevocable trusts, and the Internal Revenue Code tell us that the income and items of deduction and credit are reported or actually treated as owned by the grantor, and what we are looking at is the mechanism for reporting those items on the grantor's personal income tax returns. There are three methods, and by the way, regular grantor trusts – the revocable living trust – do not really go through this. The IRS and the regulation say an irrevocable grantor trust does not get a tax ID number. It uses the grantor's social security number on any accounts or K-1s that are issued. So, we are talking about irrevocable trusts but, which we have drafted in such a way that they will be ignored, and the grantor will be responsible for paying income tax on any earnings and reporting the items of deduction on credit on his or her tax return. The traditional method, until 1996 for reporting this, was on a Form 1041. The Form 1041 would have a statement attached to it, and that statement would say all items of the income deduction and credit are being reported on the grantor's personal return. So, we had a short Form 1041 that simply deflected the IRS over to the grantor's own personal tax return. Well, what we found is that this is an expensive income tax return. It is \$750 to \$1,000 in places such as Tucson to have this tax return prepared, and so oftentimes we would receive pushback from our clients, 'is there a cheaper way of doing this?' And so, I researched what was out there. Alternative Methods of Reporting a Grantor Trust In 1996, the IRS came up with regulations and came up with two alternative methods. One of them is far inferior to all of this. And, in fact, I did a poll in a committee meeting the other day to find out, 'had anyone ever used alternative method two,' which involves: we send the trust tax ID number, the trust name and the trustee's name and address off to the vendor, to the payor. Then, what we do is that we issue a 1099 to the grantor. So, there are two sets of 1099s—the payor, if it is a brokerage account or a bank account, is issuing a 1099 to the trustee. The trustee turns around and issues 1099s to the grantor. So, you might have 10, 11, 12 1099s coming in or K-1s coming in and then you turn around and you issue 1099s to the grantor. Then you ship all of these things off on a Form 1096, which is the transmittal form that you send to the IRS. No one has ever done it that way. It is more work, and it is more money to do it that way than any other way. The preferred way of doing it is that we can — instead of filing the 1041 with the grantor statement – is that we can file a 1040, but to do that we ship the, or we tell the payor or we tell the partnership, in the case of entity that is issuing a K-1, that this is the social security number of the grantor. This is the grantor's name, and then this is the address of the trust. All that information causes the 1099 or the K-1 to go out directly in the name of the grantor. So, we avoid all of that otherwise reporting that we have to do. And there are a couple of additional requirements but if the grantor is serving as the trustee, we do not have any additional requirements, or if the grantor is serving as a co-trustee, we do not have any additional requirements. In that situation, if they are not a trustee, they are not a co-trustee, we have to provide them with sufficient information that says, you have to report this on your income tax return. These are what these items represent, and so, it is a good bit of work. So, I come away from this saying, I am not sure that the 1041 method was the worst method. One of these other methods, unless the grantor is also the trustee, might be, when is reporting it directly with all the additional paperwork that the trustee has to provide to the grantor makes it more work, and it is going to be reviewed by the accountant. Now, let us see where these things change a little bit. Okay. If you switch from the 1041 method — that is where you file the 1041 and then we give the grantor a statement saying you are responsible for the income tax — we switch to the other method, the 1040. In that particular situation, we have to file a final 1041, tell the IRS this is a final 1041 we are doing for this trust, and then begin reporting everything on the alternative method. And the preferred one is the 1040 method. What else happens that is weird? Well, it may go the other way. It may be that we have been reporting on the 1040 method and now we are switching over to the 1041 method. Why would that ever happen? Because the grantor died. When the grantor died, at that point you cannot use the grantor's social security number. So, you have to go apply for a new tax ID number, and you start filing a 1041 as an ordinary trust. There could be situations as well — and we won't get into this — you could have a trust go back and forth between grantor and non-grantor as two different items that are being reported on the trust income tax return. If you get in that deep, you probably need additional help in reporting these things. So, in summary, there are three methods. The 1041 method, which almost everyone uses. There is the 1040 method, which my clients use if they are serving as the trustee, and then there is the 1099 method that no one but a lunatic would ever use. Thank you, Stacy. Thank you, Greg for educating us on grantor-type trust tax returns, reporting requirements and options. how to report grantor letter on 1040. how to enter grantor tax information letter. how to write a grantor letter

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